MULTIMEDIA UNIVERSITY

STUDENT ID NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 1, 2015/2016

PPE0045 – PRINCIPLES OF MACROECONOMICS

(Foundation in Management)

13 OCTOBER 2015
9.00 a.m. – 11.00 a.m.
(2 Hours)

INSTRUCTIONS TO STUDENTS

1. This question paper consists of **TWELVE (12)** pages.

2. Answer **ALL** questions in Section A and B.

3. The answers for **Section A** should be shaded on the OMR sheet. The answers for **Section B** should be written in the Answer Booklet.

SECTION A: MULTIPLE CHOICE [50 MARKS]

Instructions: Answer **ALL** questions in this section. Shade the answers on the **OMR** sheet.

1. In the definition of GDP, "market value" refers to _____.
   A. when the production took place
   B. not counting intermediate products
   C. valuing production in production units
   D. valuing production according to the market price

2. If all firms expect greater demand for their products or services, they will hire _____ resources (e.g., labour and capital) and the economy will experience _____.
   A. fewer; growth
   B. more; growth
   C. more; recession
   D. fewer; recession

3. GDP counts only final goods and services because this _____.
   A. amount can be more easily determined in the market place
   B. method avoids understating the value of GDP produced during a given year
   C. method avoids including any goods that are produced this year and sold next year
   D. method avoids double counting of goods going through several stages of production

4. Which of the following is **TRUE**?
   A. Nominal GDP increases when the prices of goods and services increase.
   B. Nominal GDP is not affected by changes in prices of goods and services.
   C. Real GDP changes only when the prices of goods and services really change.
   D. Nominal GDP does not change when the production of goods and services increases.

5. Given the aggregate demand curve, an increase in the supply of a productive resource will _____.
   A. decrease both output and prices
   B. increase output but leave prices unchanged
   C. increase the price level and decrease output
   D. decrease the price level and increase output

6. All of the following are tools of fiscal policy *except one*. Which is the exception?
   A. Taxes
   B. Interest rates
   C. Transfer payments
   D. Government purchases of goods

Continued...

7. The distinction between discretionary fiscal policy and the use of automatic stabilisers is that _____.
   A. only automatic stabilisers can stimulate the economy
   B. only discretionary fiscal policy can stimulate the economy
   C. discretionary fiscal policy, once adopted, is built into the structure of the economy
   D. automatic stabilisers, once adopted, are built into the structure of the economy

8. The introduction of a $100 autonomous net tax in an economy with an MPC equal to 0.7 will, at each level of real GDP, _____.
   A. increase consumption by $70
   B. increase consumption by $100
   C. decrease consumption by $70
   D. decrease consumption by $100

9. In the aggregate expenditure-output model, if aggregate expenditures (AE) are less than GDP, then _____.
   A. employment increases
   B. inventory will decrease
   C. inventory is unchanged
   D. inventory is accumulated

10. The effect of an increase in investment on real GDP will be greater, the larger the _____.
   A. APC
   B. MPS
   C. APS
   D. MPC

11. Which of the following is **NOT** an important characteristic of money?
   A. divisibility
   B. has stable value
   C. general acceptability
   D. has commodity value

12. The discount rate is the interest rate that _____.
   A. banks charge on large loans
   B. banks charge on loans to other banks
   C. the central bank charges on loans to banks
   D. the central bank charges on loans to the government

Continued...

13. All of the following are goals of the central bank **EXCEPT** _____.
    A. stability in interest rates
    B. a high level of employment
    C. stability in financial markets
    D. rising prices (to encourage production)

14. The reserve requirement is _____.
    A. the amount of gold required to back up all central bank notes
    B. the percentage of deposits that banks are required to hold as reserves
    C. the requirement that banks reserve part of their lending capacity to small businesses
    D. none of the above

15. The M1 money supply is defined as _____.
    A. M3 minus M2
    B. one-dollar bills
    C. all currency and checkable deposits
    D. currency and coins held by the nonbank public, checkable deposits, and traveller's cheques

16. Suppose that a bank has $6,000 in checkable deposits and the required reserve ratio is 0.2. If the bank wishes to hold no excess reserves, its actual reserves will be _____.
    A. $4,000
    B. $1,200
    C. $3,000
    D. less than $1,000

17. Banks create new deposits by _____.
    A. lending out excess reserves
    B. lending out all the reserves
    C. lending out required reserves
    D. raising interest rates on loans

18. Increasing the required reserve ratio is _____.
    A. a contractionary policy because it lowers the amount of total reserves in the banking system
    B. an expansionary policy because it raises the amount of total reserves in the banking system
    C. an expansionary policy because it raises the amount of excess reserves in the banking system
    D. a contractionary policy because it lowers the amount of excess reserves in the banking system

Continued...

19. If the money supply decreases, the opportunity cost of holding money _____ and people will want to hold _____ quantity of money.
    A. falls; a greater
    B. rises; a greater
    C. rises; a smaller
    D. does not change; the same

20. The equation of exchange is _____.
    A. $C \times I + G = Y$
    B. $M \times V = P \times Y$
    C. quantity bought equals quantity sold
    D. quantity supplied equals quantity demanded

21. Which of the following would lead to the most severe inflation?
    A. Both aggregate demand and aggregate supply increase.
    B. Both aggregate demand and aggregate supply decrease.
    C. Aggregate demand increases and aggregate supply decreases.
    D. Aggregate demand decreases and aggregate supply increases.

22. Demand-pull inflation is associated with _____.
    A. decreasing aggregate demand and lower unemployment
    B. increasing aggregate demand and lower unemployment
    C. increasing aggregate demand and greater unemployment
    D. decreasing aggregate demand and greater unemployment

23. Suppose Henry received a 5 percent increase in his nominal wage. Over the year, inflation ran about 2 percent. Which of the following is **TRUE**?
    A. His real wage increased.
    B. His nominal wage decreased.
    C. Both his nominal and real wages decreased.
    D. Although his nominal wage fell, his real wage increased.

24. In times of rapid inflation, _____.
    A. people spend less in transactions costs
    B. money loses its use as a store of value
    C. money becomes an attractive store of wealth
    D. people postpone purchases as long as possible

25. In periods of high inflation, _____.
    A. nobody wants to work and earn income
    B. the purchasing power of money is increasing
    C. high nominal interest rates are likely to result
    D. people want to hold as much money as possible

Continued...

26. If the nominal interest rate is 5 percent and there is no inflation, _____.
    A. the real interest rate is 5 percent
    B. the real interest rate exceeds 5 percent
    C. the real interest rate is less than 5 percent
    D. there is not enough information to determine the real interest rate

27. Which of the following is **NOT** considered a cost of unemployment?
    A. higher inflation rates
    B. waste of the economy's resources
    C. loss of self-respect by those who are unemployed
    D. negative psychological effects on those who have lost their jobs

28. Which of the following people would be counted in the labour force?
    A. Chou, who lost his job and last looked for work three months ago
    B. Jordan, who would like to work as a stockbroker but is now a househusband
    C. Stephanie, who holds a Ph.D. in history, but can only find part-time employment at a fast-food restaurant
    D. Steffan, who thinks he could easily earn $100,000 per year, despite the opinion of the psychiatrist at the state hospital where he is a patient

29. Consider an economy made up of 100 people, 60 of whom hold jobs, 10 of whom are looking for work, and 15 of whom are retired. The number counted as unemployed is _____.
    A. 10
    B. 15
    C. 40
    D. 25

30. Jane earned a B.S. in engineering and went to work for a defense contractor. When the government cut spending, Jane and 99 others were laid off. The only other business in the town is growing grapes, but the growers refuse to hire laid-off engineers, knowing they will leave at the first opportunity. The unemployment Jane is experiencing is _____.
    A. cyclical
    B. seasonal
    C. frictional
    D. structural

31. Frictional unemployment refers to unemployment that results from _____.
    A. a mismatch of skills
    B. taking the time to find the best job
    C. seasonal decreases in demand for labour
    D. being in the wrong geographical location

Continued...

32. Assuming the total population is 150 million, the labour force is 100 million, and 94 million workers are employed, the unemployment rate is _____.
    A. 4 percent
    B. 8 percent
    C. 6 percent
    D. 10 percent

33. A country is said to have an absolute advantage in the production of good X when _____.
    A. it specialises in the production of good X
    B. it can produce good X using fewer resources than another country
    C. its opportunity cost of producing good X is lower than another country
    D. all of the above

34. Suppose Nation A produces only two goods, X and Y. If Nation A produces only X, it can make 16X per day. If Nation A produces only Y, it can make 4Y per day. What is the opportunity cost of X in Nation A?
    A. 4Y
    B. 2Y
    C. ¼ Y
    D. ¼ X

35. The combination of goods a nation can consume after trade and specialisation begins is illustrated by _____.
    A. the supply curve
    B. the demand curve
    C. the production possibilities frontier
    D. the consumption possibilities curve

36. A possible reason a nation might impose a protectionist policy such as a tariff is to _____.
    A. increase the level of imports
    B. protect an infant industry from foreign competitors
    C. encourage specialisation in the good in which the nation has a comparative advantage
    D. none of the above

37. Trade between nations A and B _____.
    A. increases the consumption possibilities of both nations
    B. leaves the production possibilities of nation A unchanged
    C. leaves the production possibilities of nation B unchanged
    D. all of the above are true

Continued...

Refer to ***Exhibit 1*** for question no. 38.

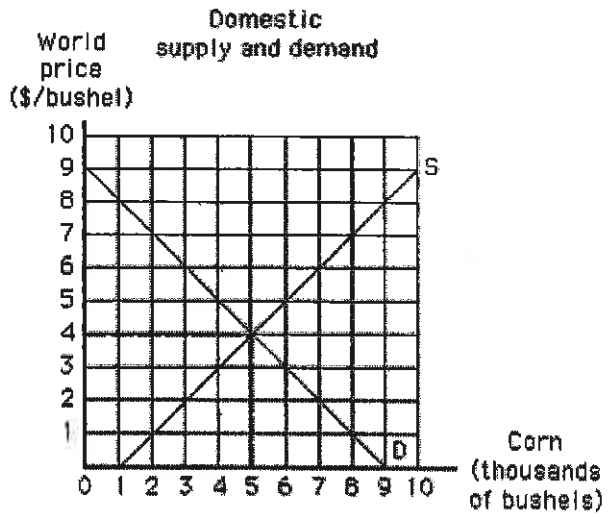

Exhibit 1

38. In ***Exhibit 1***, if the world price of corn is $2 and there are no trade restrictions, the United States will _____.
    A. be a net exporter of corn
    B. have an excess supply of corn
    C. produce 3,000, consume 7,000, and export 4,000 bushels of corn
    D. produce 3,000, consume 7,000, and import 4,000 bushels of corn

39. The rate at which nations will exchange goods and services is known as the _____.
    A. transfer rate
    B. exchange rate
    C. terms of trade
    D. terms of exchange

40. When a nation totally bans trade with another country, it is imposing a(an) _____.
    A. quota
    B. tariff
    C. embargo
    D. none of the above

Continued...

41. The balance of payments summarises the transactions that occur during a given time period between _____.
    A. individuals, firms and governments of two countries
    B. the national government and local governments in the same country
    C. the government of one country and the government of another country
    D. individuals, firms, and government of one country and individuals, firms and governments throughout the rest of the world

42. Which of the following is **NOT** classified as a service in the current account?
    A. Insurance
    B. Transportation
    C. Unilateral transfers
    D. Tourists expenditures

43. Which of the following is **NOT** considered as a unilateral transfer?
    A. foreign aid
    B. institutional charitable donations
    C. income earned from foreign investments
    D. personal gifts to friends or family abroad

44. Which of the following would contribute, directly or indirectly, to a deficit in the capital account of the U.S. balance of payments?
    A. A British citizen buys stock in Ford (an American company).
    B. A British citizen buys a bond from Ford (an American company).
    C. Interest rates fall in the United States relative to their level in the rest of the world.
    D. None of the above.

45. If Japan has a current account surplus, then it must _____.
    A. import more goods than its exports
    B. have a positive balance of payments
    C. also have a surplus in its capital account
    D. have an offsetting capital account deficit

46. If a bottle of French wine prices at 100 francs can be purchased for $50, the exchange rate is _____.
    A. 0.50 dollar per franc
    B. 0.50 francs per dollar
    C. 4.00 francs per dollar
    D. None of the above

Continued...

47. The Japanese demand curve for dollars is downward sloping because a _____.
    A. higher number of yen per dollar means U.S. goods are cheaper in Japan
    B. lower number of yen per dollar means U.S. goods are cheaper in Japan
    C. lower number of yen per dollar means U.S. goods are more expensive in Japan
    D. lower number of yen per dollar means U.S. goods are less expensive in the U.S.

48. A depreciation of Malaysia Ringgit means that _____.
    A. Malaysia's exports will become more expensive
    B. Malaysia's imports will become less expensive
    C. Malaysia's imports will become more expensive
    D. it now requires less of Malaysia Ringgit in exchange for one unit of another currency

49. An increase in the value of Japanese yen relative to U.S. dollars could be caused by a (an) _____.
    A. increase in the general level of prices in Japan
    B. increase in the supply of dollar on the foreign market
    C. decrease in the U.S. income relative to the income in Japan
    D. increase in the U.S. demand for domestically built automobiles

50. Which of the following would cause the U.S. dollar to depreciate against the Japanese yen?
    A. a higher price level in Japan
    B. higher incomes in the United States
    C. greater popularity of U.S. exports in Japan
    D. higher real interest rates in the United States

SECTION B: STRUCTURED [50 MARKS]

Instructions: Answer **ALL** questions in this section. Write your answers in the Answer Booklet.

Question 1

Part A

Exhibit 2 depicts the balance sheet of Springfield National Bank.

Springfield National Bank Balance Sheet			
Assets	RM	Liabilities	RM
Reserves	5,000	Demand deposits	10,000
Loans	5,000		

Exhibit 2

Continued...

a) If Springfield National Bank finds that it has excess reserves of RM3,000, then what is the required reserves and required reserve ratio?

(3 marks)

b) Assuming that Springfield National Bank has decided to loan out the excess reserves, how much will be the total expansion of loans?

(3 marks)

Part B

Suppose that the central bank wishes to use monetary policy to close the inflationary gap.

a) Should the central bank increase or decrease the money supply?

(1 mark)

b) If the central bank uses open market operations, should it buy or sell government securities?

(1 mark)

c) If the central bank uses required reserve ratio, should it raise or reduce the ratio?

(1 mark)

d) Illustrate with a diagram how the above action of central bank (b or c) affects the money supply and equilibrium interest rate.

(6 marks)

[TOTAL 15 MARKS]

Question 2

Exhibit 3 depicts the daily output of handbags and ties in Italy and France.

	Italy	France
Handbags	60	70
Ties	24	210

Exhibit 3

Based on ***Exhibit 3***,

a) calculate the opportunity cost of handbag for Italy and France.

(3 marks)

b) calculate the opportunity cost of ties for Italy and France.

(3 marks)

c) which country has a comparative advantage in the production of handbags? Why?

(1.5 marks)

d) which country has a comparative advantage in the production of ties? Why?

(1.5 marks)

e) suppose the terms of trade for each handbag is 2 ties. If each country specialises in the good for which it has comparative advantage and both countries agree to exchange 20 handbags for some quantities of ties, compute the consumption bundles for each country.

(3 marks)

Continued...

f) sketch a diagram for an exporting country of handbags.

(3 marks)

[TOTAL 15 MARKS]

Question 3

Part A

Exhibit 4 depicts the data for U.S. Balance of Payments.

Components of Balance of Payments	$ billions
Trade balance	-154
Merchandise exports	450
Exports of services	70
Net income from foreign investment	74
Inflow of U.S. capital	124
Outflow of U.S. capital	30
Imports of services	92
Net unilateral transfer	-5
Statistical discrepancies	4

Exhibit 4

Based on ***Exhibit 4***, calculate the following:

a) merchandise imports.

(1.5 marks)

b) service balance.

(2 marks)

c) current account balance.

(2 marks)

d) capital account balance.

(1.5 marks)

e) net change in international reserves.

(3 marks)

Continued...

Part B

Exhibit 5 depicts the demand and supply curves of U.S. dollar and equilibrium exchange rate.

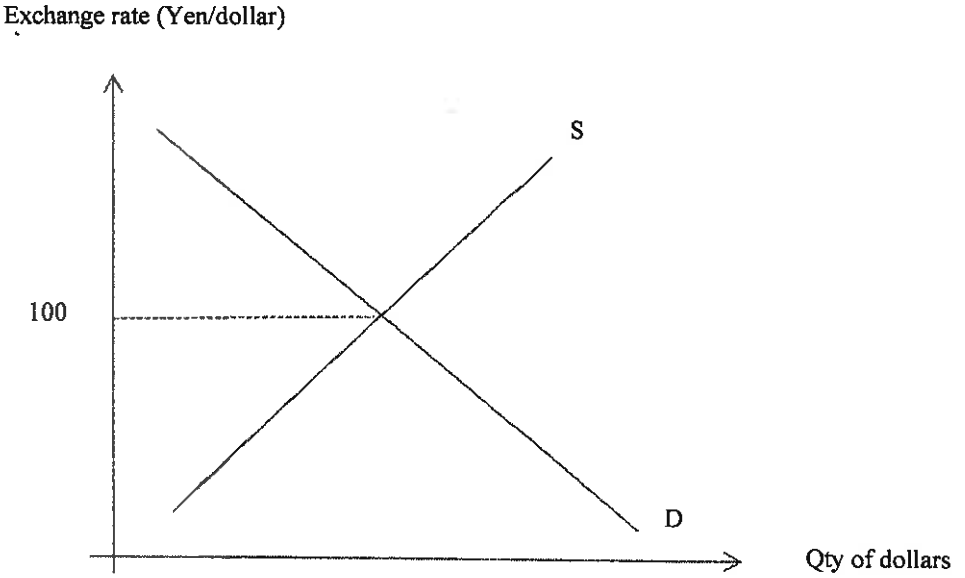

Exhibit 5

Based on ***Exhibit 5***,

a) if the exchange rate is currently pegged at 120 yen/dollar, has the dollar been overvalued / undervalued?

(1 mark)

b) what will be the impact of the pegged exchange rate on the U.S. balance of payments and official reserves account?

(3 marks)

c) to maintain the value of dollar at the official rate, what should the U.S. government do?

(2 marks)

d) in order to reduce the balance of payments deficit, what else can the U.S. government do besides using reserves?

(2 marks)

e) what will happen to the demand and supply of U.S. dollar and the equilibrium exchange rate if there is an increase in the real income of the U.S.?

(2 marks)

[TOTAL 20 MARKS]

End of paper